Testimony of

R. Daniel Blanton

On behalf of the

American Bankers Association

before the

Committee on Banking, Housing, and Urban Affairs

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Chairman Shelby, Ranking Member Brown, my name is Daniel Blanton, Chief Executive Officer of Southeastern Bank Financial Corporation and Georgia Bank & Trust, in Augusta Georgia. I am also the Vice Chairman of the American Bankers Association (ABA). I appreciate the opportunity to be here to present the views of the ABA regarding regulatory relief for small financial institutions. The ABA is the voice of the nation's $14 trillion banking industry, which is composed of small, mid-size, regional and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend more than $8 trillion in loans.

Georgia Bank and Trust is a $1.8 billion community bank established in 1989. We have 12 branches serving the Augusta area and extend $975 million in loans to our local communities.

ABA appreciates the opportunity to be here today to talk about how the growing volume of bank regulation—particularly for community banks—is negatively impacting the ability of banks throughout the nation to meet our customers' and communities' needs. This is not a new subject, yet the imperative to do something grows every day. Community banks are resilient. We have found ways to meet our customers' needs in spite of the ups and downs of the economy. But that job has become much more difficult by the avalanche of new rules, guidances and seemingly ever-changing expectations of the regulators. This—not the local economic conditions—is often the tipping point that drives small banks to merge with banks typically many times larger. The fact remains that there are 1,200 fewer community banks today than there were 5 years ago—a trend that will continue until some rational changes are made that will provide some relief to America's hometown banks.

Each and every bank in this country helps fuel our economic system. Each has a direct impact on job creation, economic growth and prosperity. The credit cycle that banks facilitate is simple: customer deposits provide funding to make loans. These loans allow customers of all kinds—businesses, individuals, governments and non-profits—to invest in their hometown and across the globe. The profits generated by this investment flow back into banks as deposits and the cycle repeats—creating jobs, wealth for individuals and capital to expand businesses. As those businesses grow, they, their employees and their customers come to banks for a variety of other key financial services such as cash management, liquidity, wealth management, trust and custodial services. For individuals, bank loans and services can significantly increase their purchasing power and improve their quality of life, helping them attain their goals and realize their dreams.

This credit cycle does not exist in a vacuum. Regulation shapes the way banks do business and can help or hinder the smooth functioning of the credit cycle. Bank regulatory changes—through each and every law and regulation, court case and legal settlement—directly affect the cost of providing banking products and services to customers. Even small changes can have a big impact on bank customers by reducing credit availability, raising costs and driving consolidation in the industry. Everyone who uses banking products or services is touched by changes in bank regulation.

The onslaught of regulatory changes has already had an impact. For example, 58 percent of banks have held off or canceled the launch of new products—designed to meet customer demand—due to expected increases in regulatory costs or regulatory risks. Additionally, 44 percent of banks have been forced to reduce existing consumer products or services due to compliance or regulatory burden.

It is imperative that Congress take steps to ensure and enhance the banking industry's ability to facilitate job creation and economic growth through the credit cycle. The time to address these issues is now before it becomes impossible to reverse the negative impacts. When a bank disappears everyone is affected. We urge Congress to work together— Senate and House—to pass bipartisan legislation that will enhance the ability of community banks to serve our customers.

In particular, Congress can take action to ensure credit flows to communities across the country by (1) improving access to home loans, (2) removing impediments to serving customers, and (3) by eliminating distortions by government in the marketplace. In the remainder of my testimony, I will highlight some specific actions under each of these that would help begin the process of providing meaningful relief to help community banks and help bank customers.

I. Improve Access to Home Loans

The mortgage market touches the lives of nearly every American household. Banks help individual consumers achieve lifelong goals of homeownership by giving them access to the funding they need. Without home loans most Americans would not be able to purchase a home.

Banks are a major source of mortgage loans—holding more than $2 trillion in one-to-four family home loans on their books and originating others under government guarantees. In addition, banks support the housing industry with construction and development loans, and homeowners with home equity lines of credit. Housing construction and development, as well as the transactional activities of buying, selling and furnishing homes, generate both direct and indirect benefits for the economy. These critical services of banks results in more income and jobs in communities, along with a larger tax base for local governments. According to the National Association of Home Builders, the construction of 100 single-family homes will result in $21.1 million in income, $2.2 million in taxes and other revenue to local governments, and 324 local jobs.

It is painfully clear that new regulatory requirements have restrained mortgage lending and have made it particularly difficult for first-time homebuyers to obtain a home loan. The complex and liability-laden maze of compliance has made home loan origination more difficult, especially for borrowers with little or weak credit history. Over-regulation of the mortgage market has reduced credit available to bank customers, raised the cost of services, and limited bank products. The result has been a housing market still struggling to gain momentum.

Congress can help reduce needless impediments to mortgage lending that have constrained the banking industry's ability to help first-time homebuyers and dampened the growth of prosperity across the nation's communities. For example, Congress should:

Treat Loans Held in Portfolio as Qualified Mortgages:
The Dodd Frank Act (DFA) is very restrictive in its definition of "ability to repay" and this is having a detrimental impact on the market and consumer access to credit. In fact, the Consumer Financial Protection Bureau (CFPB) has been forced to delay implementation of some aspects of the rule which would eliminate balloon loans. These loans, which are in virtually all cases held in portfolio, are a useful and in-demand product for many customers, particularly those in rural areas seeking smaller dollar loans and those that do not meet secondary market eligibility requirements. It helps bank manage interest rate risk and without tools like this some borrowers

would not have access to mortgage loans at all. While the bureau has recently proposed expanded exemptions for smaller lenders serving rural and underserved areas, more relief is needed for lenders and borrowers in all areas of the country.

ABA supports legislation (similar to H.R. 2673 in the 113th Congress) that would deem ***any*** loan made by an insured depository and held in that lender's portfolio as compliant with the Qualified Mortgage rule under the DFA (so long as the loan is not sold). The Qualified Mortgage or QM label is given to loans which can be shown to meet the qualifications of the Ability to Repay provisions of DFA. Loans held in portfolio are, by their very nature, loans which can be repaid; otherwise they would present safety and soundness concerns and would not be allowed by a lender's prudential regulators.

Simply put, banks would not stay in business very long if they made and held loans on their books that cannot be repaid; they hold ***all*** the risk that a loan might default. This is a common sense approach to showing that a loan has been properly underwritten and meets the QM and ability to repay requirements of the DFA without imposing additional challenges to borrowers and lenders in the lending process.

Eliminate the Excessively High Life-of-Loan Liability:

Not only are the rules complex and liability-laden, the level of liability is both high and often extends for the life of the loan. A liability with such a long life will give any lender pause when considering any but the lowest-risk borrowers. Why should ability to repay liabilities hang over a lender's business for twenty years or more into the life of a thirty-year loan? Common sense suggests that any mortgage loan that has remained current for a number of years has certainly demonstrated the borrower's ability to repay. Congress should replace the ATR life of loan liability with a more reasonable term so that liability ends after a loan has performed for a reasonable number of years.

Establish an Effective Appeals Process to the Definition of a Rural Area:

The definition of rural and underserved is critical and can dramatically affect banks and the communities they serve. The CFPB has already recognized this and has used its DFA discretionary authority to exempt certain loans from the qualified mortgage rule. This has been very important to accommodate community banks that make short-term balloon loans as a means of hedging against interest rate risk. However, the exemption applies only if, during the preceding calendar year, the creditor extended more than 50 percent of its total covered transactions that provide for balloon payments in one or more counties designated by the Bureau as "rural" or "underserved." Thus, the definitions used can be limiting and hurt mortgage customers that are inevitably in counties that may have been inappropriate excluded.

ABA supports legislation (like S. 1916 introduced last Congress by Majority Leader McConnell) that would direct the CFPB to establish an application process to have an area designated as a rural area if it has not already been designated as such by the Bureau. An appropriate exemption process is critical to a bank's ability to meet their community's needs since it would help to assure that whatever definition of rural is ultimately used by the CFPB, there would be an avenue to apply to the Bureau to extend the definition of rural in those inevitable cases where a county may have been inappropriately excluded.

Mandate a Study of the Basel III Capital Requirements Impact on Mortgage Servicing Assets:

Implementation of Basel III is disrupting the market for mortgage servicing rights by imposing punitive capital requirements that are causing many banks to sell these assets, usually to nonbank mortgage servicing firms that have little connection with the original borrowers. ABA supports legislation which requires the banking regulators to study the overall impact of these requirements on the safety and soundness of the banking system, including the impact on the value of such assets as sales are required; the financial stability of nonbank purchasers of mortgage servicing assets; and the risks posed by shifting servicing duties from the banking industry to nonbank entities. The regulators should be required to report to the committees of jurisdiction within one year on recommendations for legislative and/or regulatory changes to address concerns identified by the study, and steps to implement the provisions should be halted until Congress has the opportunity to review the study and act.

Encourage the Federal Housing Finance Agency to Reconsider its FHLB Membership Rule:

For more than eighty years Congress has maintained eligibility requirements for lenders to join the Federal Home Loan Banking system. On several occasions, including in recent years, Congress has even taken actions to expand eligibility for members in certain ways. Currently, the FHFA has proposed restrictions which might limit the ability of banks of all sizes, including community banks, from retaining this critical source of liquidity. The ABA does not object to a consideration of the best way to regulate new business structures among Home Loan Bank system members that might otherwise impose risks on the system. However, the system should retain what is essentially a self-enforcing discipline that Congress created when it first established the system. The simple matter is members cannot borrow from the Federal Home Loan Bank system unless they have eligible collateral that is contemplated by the statue. ABA will continue to work with Members of Congress to ensure that the Federal Housing Finance Agency follows Congressional intent and does not unnecessarily restrict access to vital liquidity provided by the Federal Home Loan Banks.

II. Remove Impediments to Serving Customers

Rules and requirements surround every bank activity. When it works well, bank regulation helps ensure the safety and soundness of the overall banking system. When it does not, it constricts the natural cycle of facilitating credit, job growth and economic expansion. Finding the right balance is key to encouraging growth and prosperity as unnecessary regulatory requirements lead to inefficiencies and higher expenses which reduce resources devoted to lending and investment.

The key to changing this consolidation trend is to stop treating all banks as if they were the largest and most complex institutions. Financial regulation and examination should not be one-size-fits-all. All too often, regulation intended for the largest institutions become the standard that is applied to every bank—Basel III being the most egregious. Such an approach only layers on unnecessary requirements that add little to improve safety and soundness, but add much to the cost of providing services—a cost which customers ultimately bear. Instead, ABA has urged for years that a better approach to regulation is to tailor bank supervision to take into account the charter, business model, and scope of each bank’s operations. This would ensure that regulations and the exam process add value for banks of all sizes and types.

By eliminating unnecessary impediments to the natural credit cycle, Congress can help stem the tide of community bank consolidation driven by these unnecessary impediments which negatively impacts every community across the United States. For example, Congress can:

***Reduce unnecessary and redundant paperwork*:**

Congress should require a review and reconciliation of existing regulations that may be in conflict with or duplicative of new rules being promulgated by the banking agencies, or which in their application badly fit the variety of institutions that make up the banking industry. This would help to eliminate conflicts among different regulations, thereby eliminating additional and unnecessary compliance burdens. It would also result in more effective policies. Congress should also (among other things):

- Eliminate unnecessary currency transaction report filings;
- Provide greater accountability for law enforcement's use of the Bank Secrecy Act data; and
- Eliminate redundant annual privacy policy notices by passing S. 423

Create a more balanced, transparent approach to bank examination and regulation:

Congress should expand the number of banks eligible for an 18-month exam cycle for highly rated community banks. This would reduce significantly the resources required to deal with yearly examinations by the regulators. The Comptroller of the Currency, Thomas Curry, publicly stated such a change would reduce burden on well-managed community institutions and would also allow the agencies to focus their efforts on institutions that may present supervisory concerns.

Congress should also:

- Provide an independent appeals process for bank examination decisions resulting in better accountability;
- Require the Securities and Exchange Commission and the Bank Regulators to perform cost-benefit analyses before issuing new rules; and
- Revise the cost-benefit test for rules proposed by the Commodity Futures Trading Commission.

Limit burdensome trickle-down of complex bank regulations:

Congress should support legislation that prevents the "trickle-down" of complex bank regulation onto smaller and midsized banks. For example, Congress should:

- Require targeted rulemaking by regulators that focus on the purpose of the rule, appropriately adjusted to the risk footprints of banks;
- Remove arbitrary regulatory thresholds not corresponding to a bank's risk and business model;
- Exempt small banks from Commodity Futures Trading Commission clearing requirements which would improve their ability to manage risk within the firm;
- Eliminate unnecessary public stress test disclosures for midsized banks; and
- Ensure capital rules designed for systemically important financial institutions are applied only to banks that are truly SIFIs, based on multifactor assessments of systemic risk, not merely asset size.

III. Eliminate Distortions by Government in the Marketplace

The banking industry's ability to serve customers is affected by many forces, including regulatory- or tax-advantaged nonbank competition and unreasonable legal risks. These forces restrain the credit cycle, add risk and distortions, and impede the banking industry's ability to encourage growth and prosperity within communities.

Nonbank financial institutions offer identical products and services but do so without the same regulatory oversight, consumer compliance or tax treatment. As bank regulations become increasingly restrictive, products migrate from the safety and soundness of the banking system to the under-regulated or unregulated market. This magnifies risk for all who use financial services.

Furthermore, some nonbanks benefit from special tax privileges which have created economic distortions that shift resources and banking activity from taxpaying banks to the tax-privileged sectors. Credit unions and the Farm Credit System are prime examples. Such marketplace tax distortions are neither good public policy nor fiscally responsible.

In addition, unreasonable legal risks faced by banks have restrained the credit cycle. For example, uncertainties surrounding the interpretation of fair lending rules have raised the risks of costly litigation and forced financial institutions to limit mortgage lending operations. Similarly, unjustified and abusive patent litigation and licensing fee demands have drained funds available for lending. These legal risks create no benefit for local communities. Congress should eliminate unreasonable legal risks so that the banking industry can return to the business of banking.

Another potential and serious distortion involves innovations within the payment system by nonbanks. Banks have always protected the integrity of the payments system. As new innovations come forward it is critical that they are within a secure regulatory system that promotes consumer protection and system integrity. Equal access and equivalent regulation are key principles to ensure this.

Congress should:

Support legislation that eliminates government distortions in the private market by:

- Eliminating the Credit Union industry's special tax treatment
- Ending the Farm Credit System's unjustified tax privileges
- Ensuring agencies do not impose price controls, directly or indirectly

Support legislation to eliminate unreasonable legal risks and impediments by:

- Enacting patent troll reform to reduce the threat of patent abuse
- Removing uncertainties in fair lending rules, such as penalties where there is no intent to engage in unlawful discrimination

Support Taxpaying Bank Charters by:

- Conforming savings and loan holding company thresholds and registration rules with those of banks
- Supporting charter flexibility for mutual banks and federal savings associations
- Encouraging regulators to charter new banks

Protect the Payments System by:

- Ensuring that all participants – banks and nonbanks – are subject to consistent rules and oversight for consumer protection, safety and soundness and systemic risk
- Avoiding technology mandates
- Expanding information-sharing between public and private entities to fight threats
- Ensuring all parties have consistent accountability to customers before and after breaches
- Holding breached parties responsible for costs of breaches

Conclusion

Community banks have been the backbone of hometowns across America. Our presence in small towns and large cities everywhere means we have a personal stake in the economic growth, health, and vitality of nearly every community. A bank's presence is a symbol of hope, a vote of confidence in a town's future. When a bank sets down roots, communities thrive. We urge Congress to act now to help turn the tide of community bank consolidation and protect communities from losing a key partner supporting economic growth.